

NOT FOR CITATIONUNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIASONY COMPUTER ENTERTAINMENT
AMERICA,

Plaintiff,

No. C 04-0492 PJH

v.

AMERICAN HOME INS. CO., et al.,

Defendants.

**ORDER GRANTING DEFENDANT'S
MOTION FOR SUMMARY JUDGMENT;
DENYING PLAINTIFF'S MOTION FOR
SUMMARY JUDGMENT**

The parties' cross-motions for summary judgment came on for hearing on August 24, 2005 before this court. Plaintiff Sony Computer Entertainment America ("Sony") appeared through its counsel Martin Myers and defendant American Home Insurance Co. ("American Home") appeared through its counsel Lane Ashley. Having read all submitted papers and carefully considered the relevant legal authority, the court GRANTS American Home's motion for summary judgment and DENIES Sony's motion for summary judgment.¹

BACKGROUND**A. Factual Background**

American Home sold Sony a general liability insurance policy, covering any claims brought against Sony between April 1, 2000 and April 1, 2001, for "property damage" Sheen Decl. Exh. A ("Policy"), also at Ashley Decl. Exh. 1.

The Sony Playstation 2 ("PS2") is a computer entertainment system that plays games that are programmed onto CD-ROM or DVD-ROM discs, which are inserted into its disc drive. The discs are usually sold by third party companies.

¹ Pursuant to Civ. L.R. 7-13, this order may not be cited except as provided by Civ. L. R. 3-4(e).

1 In 2002, two class action lawsuits were filed against Sony in state court, Kaen v. Sony
 2 and Kim v. Sony. Am. Home Request for Judicial Notice Exhs. B (“Kaen complaint”) and C
 3 (“Kim complaint”), also at Herp Decl. Exhs. A, B. These two cases were consolidated
 4 (“Kim/Kaen”), and allege that the PS2 was falsely advertised as able to play game discs and
 5 movie DVDs when it in fact was not. In June 2003, Sony tendered claims based on these
 6 lawsuits to American Home, but American Home denied coverage.

7 In October 2003, Sony re-tendered the claims to American Home, and submitted a
 8 compilation of customer complaints that PS2s were scratching and damaging their game
 9 discs. American Home again denied coverage.

10 B. Insurance Policy

11 1. Provisions

12 The American Home policy has the following relevant provisions:

13 Property Damage: “We will pay those sums that the insured [Sony] becomes legally
 14 obligated to pay as damages because of . . . property damage.” Policy Section I(A)(1)(a).
 15 Property damage is defined as “a) physical injury to tangible property, including all resulting
 16 loss of use of that property . . . [and] b) loss of use of tangible property that is not physically
 17 injured. . . .” Id. Section V(15).

18 2. Exclusions

19 Certain exclusions to coverage are relevant to this motion as well.

20 The policy excludes coverage for “damage to your product.” This is defined as
 21 “‘property damage’ to ‘your product’ arising out of it or any part of it.” Policy Section
 22 I(A)(2)(k).²

23 The policy also excludes coverage for “damage to impaired property or property not
 24 physically injured.” This is defined as “‘property damage’ to ‘impaired property’ or property
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26 ² “Your product” is defined as “any goods or products . . . manufactured, sold,
 27 handled, distributed, or disposed of by 1) you,” and includes “warranties or representations made
 28 at any time with respect to the fitness, quality, durability, performance, or use of ‘your product.’”
 Policy Section V(18).

that has not been physically injured, arising out of a defect, deficiency, inadequacy, or dangerous condition in 'your product' . . ." Policy Section I(A)(2)(m).³ However, the impaired property exclusion "does not apply to the loss of use of other property arising out of sudden and accidental physical injury to your product . . . after it has been put to its intended use." This is known as the "sudden and accidental" exception. Id.

C. Procedural History

Sony has filed suit against American Home, claiming breach of contract for failure to defend and indemnify, and for breach of the implied covenant of good faith and fair dealing. The parties agree that there are no disputed facts at issue, and both move for summary judgment or partial summary judgment on the question of whether American Home has breached its duty to defend Sony. American Home also moves for summary judgment on the indemnity, bad faith, and punitive damages claims.

DISCUSSION

A. Legal Standard

1. Summary Judgment

Summary judgment is appropriate when the evidence shows there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986).

2. Duty to Defend

Under Montrose Chemical Corp. v. Superior Court, an insurance carrier's duty to defend its insured from a third-party lawsuit extends broadly to require that the carrier defend all suits which even potentially seek damages that are within the scope of the policy. 6 Cal.4th 287, 299 (1993). See also, e.g., Lebas Fashion Imports v. ITT Hartford Ins. Grp., 50 Cal. App. 4th 548, 5567 (1996) (duty to defend may only be excused "when third-party complaint can by

³ "Impaired Property" is defined as "tangible property, other than 'your product' . . . that cannot be used or is less useful because . . . it incorporates your product . . . that is known or thought to be defective, deficient, inadequate, or dangerous . . .; if such property can be restored to use by the repair, replacement, adjustment, or removal of your production." Policy Section V(7).

1 no conceivable theory raise a single issue which would bring it within the policy coverage.”).
2 However, the insurer is not required to defend against speculative, unpled claims. Gunderson
3 v. Fire Insurance Exch., 37 Cal. App. 4th 1106, 1114 (1995).

4 In evaluating whether a duty to defend exists, the insurance carrier must base its
5 decision on the facts presented to it at the time of tender. Gunderson, 37 Cal. App. 4th at
6 1114; Montrose, 6 Cal.4th at 295. In making this decision, the carrier must consider the
7 allegations raised in the third-party complaint, any extrinsic evidence presented by the
8 insured, and the carrier must also conduct a reasonable investigation into the circumstances
9 of the claim. Anthem Electronics, Inc. v. Pacific Employers Ins. Co., 302 F.3d 1049, 1054-55
10 (9th Cir. 2002) (citations omitted).

11 A determination of coverage under an insurance policy is considered a question of law
12 and is thus appropriate for summary judgment. Waller v. Truck Insurance Exch., Inc., 11
13 Cal.4th 1, 18 (1995). Due to the high burden of proof borne by the insurer, though, the insurer
14 can only prevail on summary judgment if “there is no genuine issue of material fact as to the
15 potential for coverage.” Anthem, 302 F.3d at 1055 (citation omitted).

16 B. Property Damage

17 Sony argues that the Kim/Kaen complaints give rise to coverage under the “property
18 damage” provision because the Kim/Kaen plaintiffs are alleging damage to their game and
19 movie discs. Sony does not argue that the Kim/Kaen plaintiffs are alleging “loss of use” of the
20 PS2s themselves, presumably because the exclusion barring coverage for loss of use caused
21 by “damage to your product” bars claims based on product defect. Policy Section I(A)(2)(k).

22 For these claims to qualify as “property damage,” Sony must show that any damage to
23 the discs constitutes potential “physical injury to tangible property,” or “loss of use of tangible
24 property that is not physically injured.” Policy Section I(A)(1)(a), Section V(15), and that no
25 exceptions to coverage apply.

26 1. “Physical Injury”

27 Sony first argues that they have demonstrated to American Home that the discs
28

1 suffered “physical damage” sufficient for the duty to defend to arise. In reviewing the Kim and
2 Kaen complaints, it is clear that no such allegations are in fact made. Both of these
3 complaints specifically allege defects in the PS2 itself, and nothing about any damage done to
4 the discs. There is thus no legal theory on which a claim of property damage can be made.

5 Sony concedes this, but claims that even if the complaints do not contain actual
6 allegations of property damage, the information they submitted in conjunction with their re-
7 tender to American Home in October 2003 contained ample extrinsic evidence that
8 customers complained about scratched game and movie discs. Sony argues that even if no
9 theory of liability was stated in the complaint, the facts presented in these customer
10 complaints were sufficient to suggest that Sony was potentially liable for property damage and
11 thus American Home was required to defend the suit. See, e.g., Herp Decl. Exh. C (collection
12 of consumer complaints received by Sony).

13 While an insurance company is properly required to tender a defense if there is any
14 possibility of a covered claim, the insurance company is also not required to defend against
15 speculative or unpled claims. Gunderson, 37 Cal. App. 4th at 1114. At this point in the
16 Kim/Kaen action, the named plaintiffs had certified that their claims were representative of
17 those throughout the class, and that they sought damages relating only to the repair of the PS-
18 2. Ashley Decl. Exh. 9 at 194:20-195:5 (2/6/03 Kim Depo.); Exh. 10 at 186:9-18 (2/7/03
19 Hinojosa Depo.); Exh. 11 at 192:11-19 (2/25/03 Kaen Depo.). In fact, Kim specifically stated
20 that he was not claiming in the litigation that any physical damage had been done to the discs
21 or to any of his personal property. Id. Exh. 9 at 195:6-13 (2/6/03 Kim Depo.: “Q: And you have
22 never perceived that there was any damage done to any disk by the PS-2. Correct? A: Yes.”).

23 Based on this evidence, American Home properly concluded that the Kim/Kaen
24 dispute did not encompass the claims of scratched discs now proffered by Sony. American
25 Home was not required to tender a defense based solely on the extrinsic consumer
26 complaints of physical damage to third-party property, absent any evidence that those claims
27 would be asserted in the Kim/Kaen litigation, and in the face of evidence that such complaints
28

were in fact not being asserted in the Kim/Kaen litigation.

2. “Loss of Use”

Alternatively, Sony argues that even though the discs were not damaged, the consumers suffered “loss of use” within the meaning of the “property damage” provision of the Policy.

a. Design Defect versus Loss of Use

In reviewing the Kim/Kaen complaints, it is readily apparent that they are directed solely to allegations of a design defect in the PS2. See, e.g., Kaen complaint ¶ 44 (“Playstation 2 has numerous fundamental defects that make it incapable of serving as a home DVD movie player”), Kim complaint ¶ 33 (“Sony has manufactured many thousands, and perhaps millions, of Sony PS2s that possess a serious, inherent defect which makes the PS2s unable to read ‘blue-bottom’ CD games . . . and original Playstation games.”). There is thus no theory of liability stated in the complaint based on any alleged damages suffered due to the Kim/Kaen plaintiffs’ loss of use of their discs.

In fact, the Kaen complaint specifically alleges that consumers would be misled by Sony’s warranty because it would lead them to believe that “the reason a number of DVD movies do not play properly on their Playstation 2 is due to a problem with the DVD movies rather than a defect in their Playstation 2. . . . The statement leads consumers to believe that the problem lies in particular DVD movies rather than a defect in their Playstation 2.” Kaen complaint ¶ 41. (emphasis added). Similarly, the Kim complaint alleges, “Many times, class members erroneously attribute these problems [the inability to play game discs or movie DVDs] not to their new PS2 but to their CD and DVD discs, unsuccessfully attempting to clean the discs, or even discarding or replacing them.” Kim Complaint ¶ 36 (emphasis added). These statements make it clear that the Kim/Kaen plaintiffs were specifically not claiming any damage caused by the loss of use of the discs.⁴

⁴ For this reason, Anthem is inapplicable. In Anthem, the product at issue (a circuit board) was conceded to have rendered wholly inoperable all scanners into which it was incorporated. 302 F.3d at 1058. Similarly, Henrickson v. Zurich American Ins. Co. of Ill., 72 Cal.

1 However, Sony argues that the facts alleged in the complaint demonstrate that the
 2 Kim/Kaen plaintiffs were not able to use their discs because of the problems with the PS2s,
 3 and therefore they have shown a potential for coverage based on loss of use. It is true that a
 4 design defect will often have the side effect of causing the loss of use of related personal
 5 property. As American Home's counsel analogously argued at the hearing, if a washing
 6 machine breaks down and thus cannot wash clothes, the owner of the washing machine also
 7 cannot make use of his or her clothes.

8 In determining whether a "loss of use" claim has been made, courts examine the nature
 9 of the damages requested in the third-party complaint to distinguish between property
 10 damage claims and design defect issues. See Collin v. American Empire Ins. Co., 21 Cal.
 11 App.4th 787, 818 (1994). In order to show "loss of use," the plaintiff must request damages
 12 equivalent to the "rental value of similar property which the plaintiff can hire for use during the
 13 period when he is deprived of the use of his own property." Id., citing 23 Cal.Jur.3d, Damages
 14 § 69; see also F&H Construction v. ITT Hartford Ins. Co. of the Midwest, 118 Cal.App. 4th 364,
 15 377 (2004).

16 Here, the Kim/Kaen plaintiffs do not request damages for new game or movie discs,
 17 but rather, request compensation for the costs incurred in repairing the PS2s. Kim Complaint
 18 ¶¶ 50-52 (costs incurred to repair PS2); Kaen Complaint ¶¶ 38, 39 (same). Analogously, the
 19 owner of the broken washing machine does not seek compensation for the loss of the ability
 20 to wear the unwashed clothing, but rather, seeks compensation to have the washing machine
 21 repaired or replaced. Similarly, the Kim/Kaen plaintiffs do not request damages to repair or
 22 replace any damaged game discs, but rather, seek compensation to repair or replace the
 23 PS2. Viewed in this light, the Kim/Kaen complaints seek relief for design defect damages
 24 and not property damage.

25 _____
 26 App. 4th 1084, 1090 (1999), involved real property that was rendered completely unusable
 27 because defective strawberry plants were planted in the soil. Here, the discs at issue were not
 28 rendered wholly unusable in properly-functioning PS2s or other disc-reading devices, because
 they were only unusable in the defective PS2s and remained otherwise useable.

b. Policy Exclusion and Policy Exception

Because the Kim/Kaen complaints must be read solely as alleging a design defect, Policy Exclusion (m) applies. Exclusion (m) holds that any damage caused by design defects in the insured's own product are not covered under the Policy. "This insurance does not apply to . . . property damage to . . . property that has not been physically injured, arising out of a defect, deficiency, inadequacy, or dangerous condition in your product." Policy Section I(A)(2)(m). Thus, because any loss of use of the discs arises solely from the alleged design defect in the PS2, Exclusion (m) bars coverage.

However, Sony argues that even if Exclusion (m) applies, the "sudden and accidental" exception to Exclusion (m) supersedes it. That exception permits coverage to be found if the loss of use in question based on defects in the insured's own product was caused by "sudden and accidental physical injury to your product after it has been put to its intended use." Policy Section I(A)(2)(m).

However, Sony bears the burden of showing that an exception applies. Aydin Corp. v. First State Ins. Co., 18 Cal.4th 1183, 1192 (1996) (insured bears burden of proof in establishing coverage under the "sudden and accidental" exception to policy exclusion). Here, Sony provided American Home no evidence that the PS2s became unable to play discs because of any type of "sudden or accidental" injury to the PS2 device. There is nothing in the complaint or any of the other evidence presented that the PS2s suffered any sort of "sudden and accidental physical injury" that caused them to stop playing movie and game discs. Rather, the complaint makes it clear that the problems with the PS2 stem from a "fundamental defect" in the machine itself. Kaen complaint ¶ 44; see also Kim complaint ¶¶ 33-37 (describing PS2s as "suffer[ing] from a common and uniform defect"). This is thus insufficient to meet Sony's burden of proof on the applicability of the "sudden and accidental" injury exception.

Exclusion (m) thus continues to apply and no coverage exists for the Kim/Kaen complaints. Summary judgment is therefore GRANTED to American Home on Sony's claim

1 for breach of the duty to defend, and Sony's motion for partial summary judgment on the claim
2 for breach of the duty to defend is DENIED.

3 C. Remaining Claims

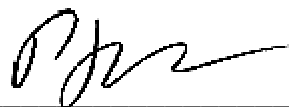
4 At the hearing, Sony conceded that all the remaining asserted claims would rise or fall
5 in conjunction with the breach of the duty to defend claim. Because summary judgment has
6 been granted on the duty to defend claim, judgment must also be granted on the claim for
7 failure to indemnify and the claim for declaratory relief. Because no breach of contract has
8 been shown, the bad faith claim fails as well. Love v. Fire Insurance Exch., 221 Cal.App.3d
9 1136, 1153 (1990). Finally, because American Home bears no liability, it's motion to strike
10 Sony's request for punitive damages is GRANTED.

11 D. Conclusion

12 American Home's motion for summary judgment on all claims is GRANTED, and
13 Sony's motion for partial summary judgment on the breach of contract claim is DENIED. This
14 order fully adjudicates the matters listed at nos. 167, 176, and 224 on the clerk's docket for
15 this case.

16 **IT IS SO ORDERED.**

17 Dated: August 30, 2005



18 PHYLLIS J. HAMILTON
19 United States District Judge
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